NOVA SCOTIA
Department of Finance

Nova Scotia Economic Outlook

November 23, 2001

Overview

This special report on the Nova Scotia economy is presented at a time of economic uncertainty and complexity. The economic landscape has changed dramatically over the last several months. When the Budget was brought down in late March, the economies of North America were expected to cool in 2001, to exhibit recovery later in the year and to achieve robust growth in 2002. But economic conditions continued to weaken into the third quarter of this year. The attacks of September 11th accelerated the economic deterioration. By then, the economic slowdown had become global in reach.

Economic forecasters quickly reduced their short-term outlook for economic growth in Canada and the provinces. Performance will be notably weaker in 2001, compared to last year. Economic conditions will remain lethargic through most of 2002 before robust recovery becomes entrenched in 2003.

Economic Growth Forecasts for Nova Scotia and Canada (Percent Change)

	2001	2002	2003
NOVA SCOTIA	**1.5**	**0.9**	**3.5**
CANADA	**1.4**	**1.5**	**4.0**

Source: Department of Finance for Nova Scotia (2001-2003); Department of Finance survey of private sector forecasts for Canada (averages for 2001-2003)

Economic Performance 2001

The Budget fully anticipated a weakening economic performance in 2001, with Nova Scotia's GDP forecast to grow 2.3 per cent and employment 0.8 per cent. This outlook was based on several key assumptions:

- Production of natural gas and gas liquids from the Sable Offshore Energy Project: (SOEP) was projected to increase 50 per cent and to provide the main source of the province's GDP growth, but the increase in offshore energy production would have little impact on job creation. SOEP's output of natural gas would be readily absorbed by the slowing U.S. economy, the destination for 82 per cent of the province's international merchandise exports. By comparison, the value of non-energy exports was expected to decline as a result of sluggish U.S. economic performance.
- Demand for goods and services: within Nova Scotia, total investment spending overall was forecast to remain weak, government expenditures on goods and services to be firm, and consumer spending, though weakening, to be sustained by further gains in income and by federal income tax cuts.

Performance year-to-date has been mixed. SOEP production is in line with expectations, with natural gas driving export performance. Despite the U.S. economic slowdown, however, the value of non-energy exports continues to show modest gains through the first eight months of the year.

- Growth in job creation is just below forecast
- Retail sales growth has been somewhat less robust than expected
- Housing starts were expected to be lower this year, but are below forecast
- GDP growth in 2001 will be somewhat lower than forecast at Budget time

Two factors in particular prompt a reduction in the province's GDP growth outlook for this year: 1. a revision in provincial economic data by Statistics Canada and 2. a re-assessment of economic conditions in the aftermath of September 11th.

First, there is an economic accounts revision growth-shift effect. Statistics Canada's late-October release of the provincial economic accounts for 2000 contained a considerable upward revision in GDP growth for 1999, to 5.7 per cent. This contributed, in part, to measured GDP growth for 2000 of 2.3 per cent, somewhat below Finance's estimate of 3.0 per cent in the Budget. Set against what was already anticipated to be a slowing in economic momentum in 2001, the newly published data dictate that GDP growth for this year be reduced, compared to the previous year.

Second, the economic shock triggered by the events of September 11th has forced a re-assessment of the economic outlook. Immediately following the event, the anecdotal evidence pointed decidedly to an adverse impact on the travel/tourism, transportation and related industries. Air transportation has experienced considerable disruption. Airlines have subsequently announced route cancellations, aircraft fleet reduction and layoffs to be implemented over the ensuing months; one national carrier has declared bankruptcy. However, the impacts of September 11th have been more inferred than demonstrated, given that economic decision-making is responding not only to the terrorist attacks but also to an already-weakening economy even before the attacks occurred.

Tourism revenues once again surpassed the $1.2 billion mark for 2001, with a projected decline of about three per cent this year. Only part of this drop is being attributed to the events of September 11th. In addition, a number of knowledge-based businesses have either closed or restructured. Moreover, there is evidence in other sectors that economic decisions are being postponed or cancelled. Overall, however, employment has held steady through the first ten months of this year, supported by positive developments in pre-development engineering, fabrication work and exploration in the offshore energy sector, establishment of new call centres, and capacity expansions in manufacturing industries.

As a result, Nova Scotia's GDP growth is now expected to average 1.5 per cent in 2001. Net job creation will increase 0.8 per cent. The unemployment rate will average 9.8 per cent for the year. For comparison, Canada's GDP growth is now forecast at 1.4 per cent and employment growth at 1.1 per cent.

Outlook

This calendar year is nearly complete, and the impact of recent events will not heavily affect overall performance for this year. The impact of the shock waves of September 11th on the economies of North America will be felt predominantly in 2002. Consumer and business confidence has been shaken. Risks and uncertainty attached to economic decision-making have increased. This adds an unusual and significant complication to economic forecasts.

At the beginning of this year, central monetary authorities in the United States and Canada began to reduce interest rates to combat emerging weakness in economic conditions. In the September 11th aftermath, interest rates have been further and sharply reduced to their lowest levels in four decades, in an attempt to bolster consumer and business confidence. In addition, the U.S. federal government is mounting an expansionary fiscal program to improve and expand internal security, to increase military spending, to provide financial assistance to support and rebuild economic infrastructure, and to stimulate consumer and business investment expenditure. The fiscal response of the Canadian government will be disclosed in the forthcoming December Budget. Strong monetary and fiscal stimulus is building in North America, but the timing and conviction of consumer and business response remains a critical question mark.

Economic forecasters have chopped GDP growth for the Canadian and provincial economies since September 11th. This is especially true for the 2002 outlook, where growth rates have been cut in half, and more. Also the range in forecasts has widened, reflecting differing expectations on when economic recovery gets underway in 2002, whether early or later in the year. There is, however, near-unanimity in the forecasts that economic performance will be strong in 2003.

Economic Growth Forecasts for Canada (Percent Change)

	2001	2002	2003
HIGH	1.6	2.0	4.3
AVERAGE	1.4	1.5	4.0
LOW	1.3	0.6	3.4

Source: Department of Finance survey of forecasters
Note: Private sector forecasts in the survey were released after September 11, 2001

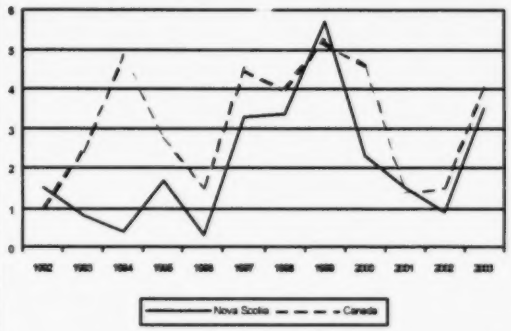
Economic Growth Forecasts for Nova Scotia (Percent Change)

	2001	2002	2003
HIGH	2.5	2.5	3.8
AVERAGE	1.7	1.7	3.4
LOW	1.0	0.6	2.6

Source: Department of Finance survey of forecasters
Note: Private sector forecasts in the survey were released after September 11, 2001

Nova Scotia's economic performance will be weak in 2002. Any recovery next year will depend critically on improvement in U.S. economic conditions. In the province, there is limited scope for increased output from the SOEP and for stepped-up exploration. Public sector spending will be restrained. Business investment expenditure will continue to be weak. The annual three-per-cent-plus growth in GDP in the second half of the 1990s was accompanied by double-digit real growth rates in business investment. A resurgence in investment, employment and economic growth will not occur until spending on the next offshore energy development project accelerates, anticipated in 2003.

Real GDP Growth, Nova Scotia and Canada, 1992-2003 (Percent Change, 1997 $)



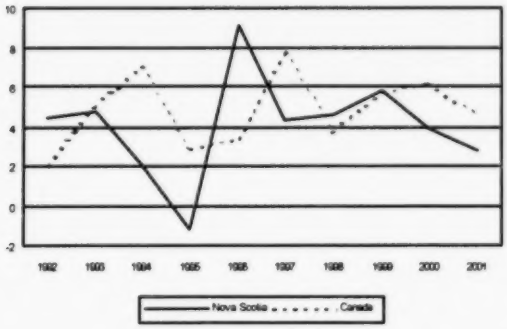
Source: Statistics Canada, Provincial Economic Accounts, cat. no. 13-213 (1992-2000); Department of Finance forecast for Nova Scotia (2001-2003); Department of Finance survey of private sector forecasts for Canada (2001-2003)

The risks appear at this time, on balance, to point to a later rather than an early recovery in 2002. Lingering apprehension of further international economic uncertainty could weigh on business and consumer confidence, but positive news on geopolitical developments would help strengthen confidence. The actual shape, magnitude and implementation timing lags of fiscal stimulus is not yet clear, but this stimulus is expected to originate primarily in the United States. U.S. imposition of duties on softwood lumber is of particular concern to Nova Scotia producers. Further depreciation in the Canadian dollar is positive for export revenues, but it also raises the cost of imported business inputs. In a sluggish global economic environment, oil prices may remain depressed. This will benefit users of oil products: for consumers, this is analogous to an increase in disposable income. In Nova Scotia, decisions on offshore energy project development are pending, and an early start would provide upside potential for the province's economic performance.

Given the heightened degree of uncertainty in the economic environment, a more prudent view is that economic recovery is a year away. On the expectation of a later rather than an early economic recovery in North America next year, Nova Scotia's GDP is forecast to grow 0.9 per cent in

2002. Employment growth will also be lower, at 0.2 per cent, and the unemployment rate will rise above 10 per cent. Next year will experience a pace of economic performance characteristic of the early 1990s. In an environment of weak economic conditions, consumer spending and retail sales growth will be restrained. Through much of the year ahead, uncertain job and income prospects can be expected to counterbalance the stimulative potential of low interest rates and federal income tax cuts.

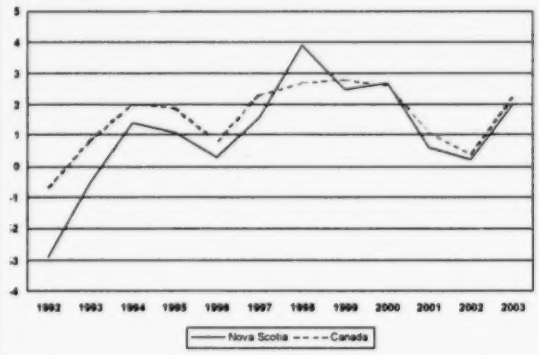
Retail Sales, Nova Scotia and Canada 1992-2001 (Percent Change)



Source: Statistics Canada, Provincial Economic Accounts, cat. no. 13-213 (1992-2000); Department of Finance forecast for Nova Scotia (2001)

Meaningful recovery in the province's economy depends on renewed strength in the U.S. and Canadian economies, and should exhibit beneficial impact on Nova Scotia by early 2003. Moreover, additional growth impetus will be provided by Deep Panuke development construction activity. In these circumstances, indicated GDP growth for 2003 is 3.5 per cent and 2.0 per cent increase in employment. Further strength to performance would be provided by positive decisions to proceed with SOEP Tier II and transmission pipeline expansion.

Employment Growth, Nova Scotia and Canada, 1992-2003 (Percent Change)



Source: Statistics Canada, Provincial Economic Accounts, cat. no. 13-213 (1992-2000); Department of Finance forecast for Nova Scotia (2001-2003); Department of Finance survey of forecasters for Canada (2001-2003)

The changed economic circumstances are expected to adversely affect anticipated growth in provincial revenues, especially in the next fiscal year. In this year, Equalization is expected to be lower than projected in the Budget. In 2002, forecasts for economic growth have been cut in half across all provinces, and even more for some provinces. Consequently, it is now expected that Equalization transfers will show little, if any, growth next year over what is now forecast for fiscal 2001-02. In addition, a major impact on corporate income tax revenue is expected as a result of weakened economic conditions and prospects in the short term. Based upon data currently available, the province is now anticipating that total revenues for upcoming 2002-03 fiscal year will be approximately $40 million less than projected for the year in our medium-term fiscal plan tabled in April 2001.

Nova Scotia's economic forecast will change as more comprehensive data are released by statistical agencies in the coming months.

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